



**STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS**

DRAFT

Date Amended:	04/25/11	Bill No:	Assembly Bill 81
Tax Program:	Sales and Use Tax	Author:	Beall
Sponsor:	Author	Code Sections:	RTC 6357.8
Related Bills:		Effective Date:	Upon enactment, but operative 01/01/12

BILL SUMMARY

This bill would, among other things, exempt from sales and use tax those gross receipts in excess of the average spot price per gallon over the previous five years on the sale or purchase of fuel and petroleum products to an air common carrier on a domestic flight, as specified, for the period January 1, 2012 until January 1, 2017, or December 31, 2019, as specified.

Summary of Amendments

The amendments to this bill since the previous analysis clarify the repeal date, the exemption language, and the definition of "domestic flight."

ANALYSIS

CURRENT LAW

Beginning July 1, 2011, the statewide sales and use tax rate (7.25%) imposed on taxable sales and purchases of tangible personal property is made up of the following components (additional transactions and use taxes (also known as district taxes) are levied by various local jurisdictions and are not reflected in this chart):

Rate	Jurisdiction	Purpose/Authority
5.00%	State (General Fund)	State general purposes (Revenue and Taxation Code (RTC) Sections 6051, 6051.3, 6201, and 6201.3)
0.25%	State (Fiscal Recovery Fund)	Repayment of the Economic Recovery Bonds (RTC Sections 6051.5 and 6201.5, operative 7/1/04)
0.50%	State (Local Revenue Fund)	Local governments to fund health and welfare programs (RTC Sections 6051.2 and 6201.2)
0.50%	State (Local Public Safety Fund)	Local governments to fund public safety services (Section 35, Article XIII, State Constitution)
1.00%	Local (City/County) 0.75% City and County 0.25% County	City and county general operations (RTC Section 7203.1, operative 7/1/04); Dedicated to county transportation purposes
7.25%	Total Statewide Rate	

The 1% General Fund tax under Sections 6051.7 and 6201.7 will expire on 6/30/11.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

Under existing law, Revenue and Taxation Code Section 6385 provides a sales tax exemption for the sale of tangible personal property, *other than fuel and petroleum products*, sold to air, water, and rail common carriers when that property is shipped to a point outside this state under specified conditions. This section additionally provides a sales tax exemption for that portion of the sale of fuel and petroleum products sold to a *water* common carrier that remains on board after the water common carrier reaches its first out-of-state destination

With respect to air common carriers, Revenue and Taxation Code Section 6357.5 provides an exemption for the entire sales price of fuel and petroleum products sold to air common carriers when the fuel and petroleum products are for immediate consumption or shipment in the conduct of the air carrier's business on an international flight. Therefore, if an air common carrier's final destination were France, for example, current law would exempt the entire sale of fuel purchased in California, even if that carrier had stops in Los Angeles and New York before reaching its final destination. On the other hand, if the air carrier's final destination was somewhere in the United States, current law would impose tax on the entire sale of the fuel in California.

In addition to these exemptions, Revenue and Taxation Code Sections 6366 and 6366.1 contain exemptions for the sale and purchase or lease of aircraft to persons using the aircraft as a common carrier. Component parts of the aircraft as a result of the maintenance, repair, overhaul, or improvement of that aircraft in compliance with Federal Aviation Administration requirements, and any charges made for the labor and services rendered with respect to that maintenance, repair, overhaul, or improvement are also exempt from tax.

PROPOSED LAW

This bill would add Revenue and Taxation Code Section 6357.8 to the Sales and Use Tax Law to provide an exemption from January 1, 2012 until January 1, 2020 from the computation of the amount of tax on the gross receipts or sales price in excess of the average spot price over the previous five fiscal years, per gallon (hereafter referred to as the average spot price), as determined by the BOE, from the sale or purchase of fuel and petroleum products by an air common carrier on a domestic flight. If enacted, only the amount determined by the BOE to be the average market price over the last five years per gallon would be subject to tax.

For the 2011-12 fiscal year, the BOE would determine the average spot price by October 1, 2011. For the 2012-13 fiscal year, and each fiscal year thereafter, the BOE would make the average spot price determination by March 1 preceding that fiscal year.

This bill defines the term "domestic flight" to mean a flight whose final destination is a point inside of the United States.

This bill would also define the term "air common carrier" to mean a common carrier as defined in Business and Profession Code Section 23046.

This bill would provide that the exemption does *not* apply to any tax levied pursuant to Bradley-Burns Uniform Local Sales and Use Tax Law and Transactions and Use Tax Law, unless approved by the local government that would otherwise receive the revenues derived from the taxes imposed under those laws.

Beginning January 1, 2013, the BOE would be required to submit an annual report to the Legislature regarding the fiscal impact of the bill's proposed exemption.

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The bill also provides a sunset date of January 1, 2017, unless the Employment Development Department (EDD) makes a finding that at least 2,000 jobs have been created as a result of this exemption, in which case the repeal date would be January 1, 2020.

As a tax levy, the bill would become effective immediately, but would be operative January 1, 2012.

BACKGROUND

Until July 15, 1991, sales of fuel and petroleum products to air, water, and rail common carriers were exempt from sales tax when used in the conduct of the carriers' common carrier activities after the first out-of-state destination. The rationale for this exemption was that it made California ports and airports more competitive, and it established consistency in the Sales and Use Tax Law for interstate and foreign commerce sales by exempting that portion of the fuel which was actually transported outside this state prior to any use. However, because of the budget crisis in 1991, this exemption was repealed by AB 2181 (Stats. 1991, Ch. 85) and SB 179 (Stats. 1991, Ch. 88).

In 1992, however, AB 2396 (Ch. 905) restored this exemption for fuel and petroleum products, but only with respect to water common carriers, and only until January 1, 1998. The sponsors of that measure, Pacific Merchant Shipping Association, successfully argued before the Legislature that the July 1991 repeal of the exemption had been directly responsible for a decline in the number of ships which bunker in California ports, and that reinstating the exemption would increase bunker activity in California. The sunset date of January 1, 1998 was extended until January 1, 2003 by AB 366 (Stats. 1997, Ch. 615). Subsequent legislation extended the sunset date to January 1, 2014 (Ch. 712, SB 808, Stats. 2003).

Two bills to restore the exemption for air and rail common carriers were introduced in the 1996 Legislative Session. AB 3375 (Olberg) would have restored the exemption for rail common carriers. AB 566 (Kaloogian) would have restored the exemption for air common carriers. According to a Department of Finance analysis of AB 566, "Governor Wilson has proposed a different form of tax relief for the aircraft industry. Under the Governor's proposal, a sales tax exemption would be extended to property that becomes a component part of an exempt aircraft as a result of maintenance, repair, overhaul, or improvement of the aircraft in compliance with FAA requirements." The Governor's proposal was actually enacted in the 1996 Legislative Session by SB 38 (Lockyer, et al., Stats. 1996, Ch. 954) which, among other things, included the sales tax exemption for the component parts.

Four bills over the last several years have been introduced that would also have exempted from sales tax that portion of the sale of fuel and petroleum products sold to an air common carrier that is left on board after the air common carrier reaches its first out-of-state destination:

- AB 1800 (Machado, 1998) was held in the Assembly Appropriations Committee.
- AB 2470 (Wiggins, 2000) died in Assembly Revenue and Taxation Committee.
- SB 1510 (Knight, 2002) died in Senate Revenue and Taxation Committee.
- SB 998 (Margett, 2005) died in Senate Revenue and Taxation Committee.

Five other bills, similar to this bill, would have exempted from the sales and use tax, those gross receipts in excess of a specified amount per gallon on the sale or purchase of fuel and petroleum products by an air common carrier on a domestic flight:

- AB 2897 (Wiggins, 2002) would have exempted those gross receipts in excess of \$0.50 per gallon on the sale or purchase of fuel and petroleum products by an air common carrier. This bill was held in the Assembly Appropriations Committee.
- AB 236 (Bermudez, 2005) would have exempted those gross receipts in excess of \$0.632 per gallon on the sale or purchase of fuel and petroleum products by an air common carrier. This bill died in Assembly Revenue and Taxation Committee.
- SB 1619 (Dutton, 2006) would have exempted those gross receipts in excess of \$1.131 per gallon on the sale or purchase of fuel and petroleum products by an air common carrier. This bill died in the Senate Revenue and Taxation Committee.
- SB 359 (Runner and Dutton, 2007) would have exempted those gross receipts in excess of \$1.66 per gallon on the sale or purchase of fuel and petroleum products by an air common carrier. This bill was not heard in a policy or fiscal committee.
- SB 98 (Budget Committee, 2007) among other things, beginning July 1, 2008, would have exempted those gross receipts in excess of \$1.93 per gallon on the sale or purchase of fuel and petroleum products by an air common carrier. This budget trailer bill died on the Senate inactive file.

COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the author to create a cap on the state sales tax imposed on each gallon of fuel and petroleum product sold to or purchased by an air common carrier for immediate consumption or shipment in the conduct of its business on a domestic flight. The author indicates that the airlines need a stable and efficient tax structure, as the domestic passenger aviation system is a key to California's economic competitiveness and recovery.
2. **The April 25, 2011 amendments** clarify the repeal date, specify that the exemption amount also includes "sales price" as well as "gross receipts," as provided, and change the definition of "domestic flight" to include only points inside the U.S.

Unrelated to the BOE, the amendments also require EDD to submit a report to the Legislature and the Department of Finance on or before October 1, 2016, determining whether 2,000 or more jobs have been created, or are expected to be created, on or before January 1, 2017, as a result of this measure.

3. **All air common carriers wouldn't be treated alike.** This bill defines an air common carrier by referencing Business and Professions Code Section 23046. This section defines "air common carrier" to mean "a person engaged in regularly scheduled air transportation between fixed termini under a certificate of public convenience and necessity issued by the Civil Aeronautics Board, or its successor, or the Public Utilities Commission, or its successor, and 'airplane' or 'common carrier airplane' means an airplane operated in air transportation by an air common carrier." This definition is used in terms of the applicability of alcoholic beverage licensing laws to air common carriers selling distilled spirits on board airplanes operating in this State.

The BOE, however, has defined “air common carrier” for purposes of the sales and use tax exemptions currently applicable to these persons through its Regulation 1621, *Sales to Common Carriers*. This regulation defines common carriers to include carriers such as those defined in this bill as well as other carriers, such as charter carriers, private carriers, or contract carriers, so long as they are engaged in the business of transporting persons or property for hire or compensation and offer these services indiscriminately to the public or some portion of the public. Is it appropriate to have two different definitions in law for the same term? This could add confusion in the proper reporting of those sales to carriers that remain subject to tax.

4. **The local government option, if exercised, would eliminate the uniform base of local and district taxes.** The bill would allow local governments to opt into the proposed exemption if they vote to do so. If no local governments opted into the proposed exemption, sales of fuel and petroleum products would be exempt at the rate of 6.25% (the state rate of 5.25%, the 0.5% Local Revenue Fund rate, and the 0.5% Local Public Safety Fund rate). All sales made within jurisdictions imposing a district tax would be subject to only the district tax rate.

However, if local governments opt into the exemption, California would be left with a variety of differing rates on sales of fuel and petroleum products. Some practical questions would arise as well. For example, if a county doesn’t opt into the exemption for its Bradley-Burns tax (1.25% less city credits), but a city does (1% or less), does the entire Bradley-Burns tax then go to the county within the city limits? That is, would the offsetting city credit disappear?

In addition to the likelihood of increased errors on sales and use tax returns, there would be an added burden placed on the retailers making the sales. The retailers receive no direct economic benefit from the proposed exemption, yet the retailers would be required to (1) program their computers to allow for a separate rate for the fuel sold to air carriers on a domestic flight versus all other fuel and petroleum product sales, (2) obtain and retain necessary documentation to support any exempt sales to qualifying carriers, and (3) account for the exempt sales for purposes of properly reporting their sales and use tax obligations to the BOE.

5. **Funding necessary for administrative start-up costs.** The provisions of this bill would be effective immediately but would be operative on January 1, 2012, in the middle of the 2011-12 fiscal year. The BOE would incur administrative start-up costs related to, among other things, notifying affected taxpayers, modifying tax returns, revising regulations and pamphlets, answering inquiries from industry and the public, and programming. Since these costs would not be identified in the BOE's 2011-12 budget, the BOE would need an adequate direct appropriation to cover these costs.

Staff will work with the author's office to address this issue as the bill progresses through the legislative process.

6. **Sunset date extension is contingent on airline industry creating 2,000 jobs.** This exemption will be repealed by January 1, 2017, unless the EDD makes a finding on or before January 1, 2017, that 2,000 jobs have been created as a result of this exemption. If EDD makes the finding, then the sunset date for the exemption is extended to January 1, 2020.

In general, the BOE is responsible for the administration of the provisions of the Sales and Use Tax Law, as such, the BOE has general responsibilities related to registration, return processing, performing collections, conducting audits, providing information, deciding appeals, and other tax related functions. The BOE does not require, obtain, or maintain information or records related to employment figures for sales tax purposes.

COST ESTIMATE

Administrative costs would be incurred in notifying affected taxpayers, modifying tax returns, revising regulations and pamphlets, answering inquiries from industry and the public, programming changes, auditing claimed amounts, revising sales tax returns, and reviewing returns with claimed exemptions. In addition, because of the potential for a partial tax exemption, with some local governments opting in on the exemption, administrative costs would also be incurred in computer programming, return analysis, and return processing. An estimate of these costs is pending.

REVENUE ESTIMATE

BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

Estimated California Jet Fuel Expenditure. According to the U.S. Energy Information Administration (EIA), total sales of jet fuel in California for the FY 2009-10 were 3.8 billion gallons. Approximately 10%, or 380 million gallons of jet fuel sold in California is for military use. Therefore, in FY 2009-10, 3.4 billion gallons (3.8 billion gallons – 0.38 billion gallons = 3.42 billion gallons) of jet fuel was used by commercial air carriers. According to the Bureau of Transportation Statistics (BTS), total gallons consumed in the U.S. in FY 2009-10 was 17 billion gallons. The fuel consumed by international flights accounts for 5.8 billion gallons, which comprises 34 percent (5.8 billion gallons / 17 billion gallons) of jet fuel consumed.

Currently, expenditures on fuel for international flights are exempt from sales and use tax. Assuming that jet fuel usage in California is consistent with the national average, the fuel used for domestic flights is 2.2 billion gallons (3.4 billion gallons x 66 percent = 2.2 billion gallons). As of March 18, 2011, the spot price of jet fuel in Los Angeles was \$3.184 per gallon, provided by Oil Price Information Service (OPIS). Since the EIA is no longer providing the California jet fuel spot prices, we used the forecasting model created by Global Insight and determined that the average jet fuel market prices are \$2.394 for FY 2011-12, and \$2.393 for FY 2012-13.

This bill would exempt that portion over \$2.394 or \$0.790 per gallon for 2011-12, and \$2.393 or \$0.791 per gallon for FY 2012-13. Therefore, the total expenditures for FY 2011-12 that qualify are estimated to be \$1.738 billion (2.2 billion gallons x \$0.790 per gallon = \$1.738 billion), and the total expenditures for FY 2012-13 are estimated to be \$1.740 billion (2.2 billion gallons x \$0.791 per gallon = \$1.740 billion).

REVENUE SUMMARY

Since the operative date of this measure is January 1, 2012, exempted expenditures in FY 2011-12 will amount to \$0.869 billion (\$1,738 billion / 2) and \$1.740 billion for FY 2012-13 in jet fuel sales, the revenue loss in California are as follows:

	Revenue Loss (In millions)	
	FY 2011-12 ½ year impact	FY 2012-13
State (5.00%)	43.5	87.0
Fiscal Recovery Fund (0.25%)	2.2	4.4
Local Revenue Fund (.50%)	4.3	8.7
Public Safety Fund (0.50%)	4.3	8.7
Total	54.3	108.8

Qualifying Remarks. Due to the recent volatility in oil prices, this bill is likely to result in a higher revenue impact.

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